CERTIFICATE.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1904.

No. 116.

GUILFORD B. KEPPEL, TRUSTEE, &c.,

vs.

TIFFIN SAVINGS BANK.

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

FILED SEPTEMBER 17, 1903.

(19,069.)

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JUDD & DETWEILER, PRINTERS, WASHINGTON, D. C., JULY 11, 1904.

1 United States Circuit Court of Appeals, Sixth Circuit.

GUILFORD B. KEPPEL, Trustee, etc., Appellant, vs. TIFFIN SAVINGS BANK, Appellee.	)	No. 1177. Appeal from the District Court of the United States for the Northern District of Ohio.

Before Lurton and Severens, circuit judges, and Wanty, district judge.

This is an appeal from a judgment of the district court sitting in bankruptcy for the northern district of Ohio, allowing three claims filed against the estate of one Charles A. Goetz, a bankrupt, by the Tiffin Savings Bank.

From the transcript of the record it appears:

1. That Charles A. Goetz was upon his own petition adjudged a bankrupt October 12, 1900, and that the appellant Geo. B. Keppel was duly appointed trustee of the estate of the said bankrupt.

2. On September 17, 1901, the Tiffin Savings Bank filed for allowance four certain claims against the bankrupt's estate, to wit:

One note for $4,000.00 dated November 1, 1897.

One note for $2,000.00 dated October 9, 1900.

One note for $880.00 dated October 9, 1900.

One note for $35.00 dated October 11, 1900.

3. This note for $4,000.00 was secured by a real estate mortgage made in good faith more than four months before bankrupt's adjudication.

4. The note for $2,000.00 was made for a pre-existing debt and was secured by a mortgage of even date upon a second piece of real estate, the mortgagor being then insolvent and having an intent to prefer the said Tiffin Savings Bank.

5. Neither of the other notes were secured.

6. The trustee instituted suit in an Ohio court of common
2 pleas against the said Tiffin Savings Bank to recover as a part of the estate of the bankrupt the two parcels of real estate included within the two mortgages above mentioned and to have the mortgages aforesaid cancelled as null and void.

7. The said Tiffin Savings Bank defended and asserted the validity of both securities, and by its cross-petition sought to have same enforced.

8. The first cause of action was upon the mortgage made to secure the note for $4,000.00 and was decided against the trustee, and a decree enforcing the mortgage was pronounced upon the cross-petition of the mortgagee.

9. The said court of common pleas found in favor of the trustee upon his second cause of action finding the mortgage was made within four months of the mortgagor's adjudication as a bankrupt

and that it was made to secure a pre-existing debt and with a design to prefer the said Tiffin Savings Bank. It was, therefore, adjudged by the said common pleas court that said mortgage be annulled.

10. From the judgment and decree as an entirety the plaintiff appealed to the circuit court of Seneca county, Ohio, and perfected his appeal.

11. Upon the trial in the circuit court judgment was again given against the plaintiff upon his first cause of action and for the plaintiff upon the second cause of action. This judgment has not been reversed or annulled and remains undisturbed.

12. When the claims of the Tiffin Savings Bank were filed for allowance objection was made to the allowance of any one of them upon the ground that the said bank had not surrendered the preference resulting from the two mortgages to secure the two larger notes.

13. The claim for $4,000.00 was satisfied by the proceeds of the sale of the property mortgaged to secure that debt, and the question of its allowance as a claim against the bankrupt's estate consequently never came on for decision.

14. Only the trustee appealed from the judgment of the common pleas court, but that appeal took up the whole case which was retried in the circuit court upon the same pleadings and upon such evidence as the parties produced. There was evidence tending to show, that upon the retrial of the case in the said circuit court that the attorney representing the Tiffin Savings Bank announced to the court that the bank did not and could not maintain the preference secured by the mortgage to secure the $2,000.00, and that it
3 waived any preference thereunder. There was also evidence tending to show that although the bank declined any contention for the preference under the $2,000.00, its attorney refused to consent to judgment in favor of the trustee lest it might "prejudice its claim to dividends."

15. When the claims in question came on for allowance the referee ruled that the preference resulting from the $2,000.00 not having been "voluntarily surrendered" operated to prevent allowance of any claim whatever in favor of the said Tiffin Savings Bank and disallowed each of the three claims in question. Upon petition for review, Judge Wing, the district judge, reversed the referee, holding that the resistance interposed in the State court to the suit of the trustee to deprive the bank of its $2,000.00, did not operate to prevent the allowance of its claims.

16. Upon this state of facts this court desires the instruction of the Supreme Court that it may properly decide the questions of law thus arising and accordingly directs that the following questions be certified:

First. Can a creditor of a bankrupt, who has received a merely voidable preference, and who has in good faith retained such prefer-

ence until deprived thereof by the judgment of a court upon a suit of the trustee, thereafter prove the debt so voidably preferred?

Second. Upon the issue as to the allowance of the bank's claims was it competent, in explanation of the judgment of the Ohio circuit court in favor of the trustee and against the bank in respect of its $2,000.00 mortgage, to show the disclaimer made in open court by the attorney, representing the bank of any claim of preference, and the grounds upon which the bank declined to consent to a judgment in favor of the trustee?

Third. If the failure to "voluntarily" surrender the mortgage given to secure the $2,000.00 note operates to prevent the allowance of that note, does the penalty extend to and require the disallowance of both the other claims?

July 22, A. D. 1903.

HORACE H. LURTON,
Circuit Judge.
HENRY F. SEVERENS,
Circuit Judge,
GEO. P. WANTY, *Dist. Judge,*
Judges of the U. S. Circuit Court of Appeals for the Sixth Circuit.

4 United States Circuit Court of Appeals for the Sixth Circuit.

UNITED STATES OF AMERICA, *Sixth Judicial Circuit,* } ss:

I, Frank O. Loveland, clerk of the United States circuit court of appeals for the sixth circuit, do hereby certify that the foregoing certificate and statement of facts in the case of Guilford B. Keppel trustee etc. — Tiffin Savings Bank was duly filed and entered of record in my office by order of said court, and as directed by said court, the said certificate is by me forwarded to the Supreme Court of the United States for its action thereon.

In testimony whereof, I have hereunto subscribed my name, and affixed the seal of said court, at the city of Cincinnati, Ohio, this 7th day of Aug. A. D. 1903.

[Seal United States Circuit Court of Appeals, Sixth Circuit.]

FRANK O. LOVELAND,
Clerk of United States Circuit Court of Appeals for the Sixth Circuit.

[Endorsed:] United States circuit court of appeals for the sixth circuit. Guilford B. Keppel trustee *v.* Tiffin Savings Bank. Questions certified to the Supreme Court of the United States.

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JAMES H. McKENNEY
Clerk

Supreme Court of the United States,

OCTOBER TERM, 1904.

NO. 116.

GUILFORD B. KEPPEL, TRUSTEE, Etc.,

vs.

TIFFIN SAVINGS BANK.

BRIEF FOR TRUSTEE.

HENRY WELLER and
BUNN & ROYER,
Attorneys for Plaintiff.

ADVERTISER, TIFFIN, OHIO.

Supreme Court of the United States,

OCTOBER TERM, 1904.

NO. 116.

GUILFORD B. KEPPEL, TRUSTEE, Etc.,

vs.

TIFFIN SAVINGS BANK.

BRIEF FOR TRUSTEE.

This cause comes into this Court upon the certificate of the Circuit Court of Appeals for the Sixth Circuit.

The facts are stated and instructions are asked on three questions. We will consider these questions in their order.

> "First: Can a creditor of a bankrupt, who has received a merely voidable preference, and who has in good faith retained such preference until deprived thereof by the judgment of a Court upon a suit of the trustee, thereafter prove the debt so voidably preferred?"

The answer to this question is found in paragraph g, section 57, of the present Bankrupt Act. The language of this

paragraph at the time the question arose in this cause was as follows:

"The claims of creditors who have received preferences shall not be allowed unless such creditors shall surrender their preferences."

What is the meaning of this provision — when and how must a creditor surrender his preference in order that his claim or claims may be allowed?

Our contention is that the surrender must in all cases be voluntary and must, therefore, be made before any Court has, by its judgment, avoided the preference.

It is true that the word, surrender, is used with widely different meanings. A general surrenders his army under pressure when he can fight no longer, or when to continue the fight would mean the complete annihilation of his soldiers. But this is not the primary meaning of the word. It is to render over: "To give back; render again; restore." (Century Dictionary). In law the term has had a technical meaning since the days of Littleton, and was used in conveying "an estate for life or years to him who has an immediate estate in reversion or remainer," (Bouvier). These meanings imply a voluntary act.

That Congress intended a voluntary surrender, we think, will appear quite clearly from a history of legislation and judicial construction on this point.

The Bankrupt Act of 1867, as originally passed, had this provision in section 23: "Any person who, after the approval of this act, shall have accepted any preference, having reasonable cause to believe that the same was made or given by the debtor, contrary to any provision of this act, shall not prove the debt or claim on account of which the preference was made or given, nor shall he receive any dividend therefrom until he shall first have surrendered to the assignee all property, money, benefit, or advantage received by him under such preference." * * * * 14 Statutes at Large, 517.

By the amendment of 1874, the foregoing provision ap-

pears to have been repealed (section 21) and in its stead was provided that a person who has received a preference, "if a creditor, shall not in case of actual fraud on his part, be allowed to prove more than a moiety of his debt;" 18 Statutes at Large, p 178.

It is not very clear what became of this amendment, for in the Revised Statutes of 1878 the original provision, with some necessary verbal changes, again appears as section 5084.

Compared with these provisions of the former bankrupt law, paragraph g, section 57, of the present act is certainly clear and explicit. Plurals are used instead of singulars, and for the word "until" (a limitation as to time only) the word "unless" (a limitation as to choice or election) is substituted.

By omitting from the present law the amendment of 1874, and all provisions similar thereto, and adopting language stronger and clearer than the surrender clause of the original act of 1867, Congress must have intended a construction not less severe than that given to such original act prior to its amendment.

We therefore call the Court's attention to the following cases in which the surrender clause of the Act of 1867, prior to its amendment, was construed:

In re Lee, No. 8179 Fed. Cases, s. c. 14 N. B. R. 89.
In re Richter, No. 11,803, Fed. Cases, s. c. 1 Dill. 544.
In re Leland, No. 8,230, Fed. Cases, s. c. 7 Ben. 156.
In re Stephens, No. 13,305 Fed. Cases, s. c. 3 Biss. 137.
In re Drummond, 4094 Fed. Cases, s. c. 4 Biss 149.
In re Graves, 9 Fed. Rep. 816.

For the convenience of this Court, we will here give some extracts from these cases. We do this the more cheerfully because the Judges quoted, though not sitting as Courts of last resort, bear honored names in our jurisprudence:

IN RE RICHTER ESTATE.

Decided in 1870 by Judge Dillon.

> "1. Where an assignee brings his action under the 35th section of the bankrupt act (of 1867 (14 Stat. 534)) to recover of a creditor of the bankrupt property alleged to have been sold or conveyed to him in fraud of the act, and where the defendant in such action denies his liability, resists a recovery, goes to trial, and judgment passes against him, such a judgment conclusively establishes that the creditor sought to obtain a fraudulent preference. Payment of such a judgment under execution issued is not such a surrender as is contemplated by section 23 of the act, and will not entitle the party to prove up the claim, in satisfaction of which he received property from the bankrupt by way of illegal preference."

In his opinion in this case Judge Dillon says, among other things: "The cardinal idea of the bankrupt act is an indiscriminating distribution of all the effects of the debtor, to all of his creditors. This legislation is essentially founded upon the doctrine that equality is equity. When a debtor finds himself embarrassed, experience has shown that there arises in his mind a strong temptation, either to conceal his property, or to distribute it as his favor or his enmity, or both may dictate. * * * * The temptation to prefer, and the danger of doing so, inhere in the situation of an insolvent debtor; and hence it is (to use language applied to purchases of trust property by trustees) 'the wise policy of the law has put the sting of a disability into the temptation, as a defensive weapon against the strength of the danger

which lies in the situation.' Notes to Fox vs. Mackreth 1 Lead Cas. Eq. 161."

"The 18th, 23rd, 29th, 35th, and 39th sections of the bankrupt act abundantly evince the anxiety of the Legislature to guard against preferences, which operate as a fraud upon the policy of the act. Such preferences are not only prohibited and declared void, but certain penalties are denounced against creditors who, under the circumstances specified, accept of preferences."

"So that the bankrupt act says decisively to every person who, under the circumstances specified, has received a preference: 'Surrender what you have received and you shall lose nothing. If you refuse, and the assignee recovers the property or its value you shall get nothing. Make your election.'"

IN RE STEPHENS ESTATE.

Decided in 1872 by Judge Hopkins.

> "1. A full surrender of a creditor of a preference fraudulent under the act restores him to all his rights, and he may prove his claim against the estate."
>
> "2. Whether this may be done after suit is brought, is a matter of discretion with the court. It will not be allowed after a recovery."

We also quote the following from the opinion: "The preference is what the law denounces, the intent of the act being to secure an equal distribution of the estate of a bankrupt among all his creditors; and if a creditor voluntarily yields a preference he may have acquired or attempted to acquire, and surrenders all the property, so that it does not in any manner interrupt the equal distribution required by the act, the party is restored to his rights as they stood before the preference. If a creditor, having received preference, refuses

to surrender, and a suit is prosecuted against him by the assignee for the property or money unlawfully received as a preference, and a recovery is had against him, he cannot then surrender and receive the benefits of that section."

"A party should not be allowed to experiment and speculate upon the ability of the assignee to prove a case against him, and when he sees he has succeeded then to plead guilty and surrender, and take the benefit of section 23. Such a practice ought not to be tolerated."

IN RE LELAND ESTATE.

Decided in 1874 by Judge Blatchford.

> "This provision of the 39th section is to be construed in connection and in harmony with the provision of the 23rd section; and there cannot be such a surrender by the creditor, as is spoken of in the 23rd section, after there has been a recovery of the property by the assignee under the 39th section, or under the 35th section."

We also quote the following from the opinion:

"If, under the 23rd section, the preferred creditor were allowed to surrender to the assignee the property received in preference, even after it has been recovered back by the assignee as mentioned in the 39th section, so as to be able to prove his debt, no creditor taking a preference could ever be debarred from proving his debt. If, under the 39th section, it were held that the mere taking of a preference by a creditor would debar him from proving his debt, without the precedent necessity for a recovery back by the assignee of the property conveyed in preference, there never could be any scope for the operation of the 23rd section in respect to a surrender. The interpretation heretofore given by this court to these provisions of the 23rd and 39th sections has

been (in re Davidson (Case, No. 3,599)) that the clause in the 39th section, in respect to not allowing the creditor to prove his debt in bankruptcy, applies only to cases in which the assignee is compelled to resort to legal proceedings to recover the property transferred in violation of the act; that the creditor who claims to retain the property makes himself conclusively a party to the fraud against the act, by resisting the claim of the assignee to recover the property in case the assignee is successful; but that, where the creditor avails himself of the locus poenitentiae given to him by the 23rd section, by voluntarily surrendering the property to the assignee, he ceases to be a party to the fraud, and may prove his debt in bankruptcy and receive dividends on it. This view is concurred in by Judge Longyear, in re Scott (Case No. 12,518), and in re Kipp (Id. 7,836); by Judge Deady, in re Walton (Cases Nos. 17,128, 17,130); by Judge Hopkins, in re Stephens (Case No. 13,365); and by Judge Dillon, in re Richter (Id. 11,803)."

IN RE LEE ESTATE.

Decided in 1876 by Judge Wallace.

> "2. Under the prior law a preferred creditor who did not surrender his preference until he was compelled to do so by the judgment of a court, could not prove his debt."

We also quote the following from the opinion:

"Second. Treating the case as one to be determined by the law in force prior to the amendments, the creditor who has not surrendered a preference until he has been compelled, after contest, to do so by the judgment of the court, is precluded from proving the debt upon which the preferential payment was received. I have held repeatedly that under the terms of the 23rd section of the act, prior to the amendment,

a voluntary surrender was a pre-requisite to the right to prove, and that it was too late for the creditor to avail himself of the privilege after he had elected to contest the assignee's title to the money or property preferentially received. Whether the action of the creditor was in actual fraud of the act, or only a constructive fraud upon it, he is chargeable with knowledge of its illegality, and must be assumed to have made his election with such knowledge."

We might quote from other cases to the same effect; but the foregoing, we think, are sufficient to remind this Court of the construction given to the surrender clause of the former bankrupt law. While some of the judges allowed a surrender pending litigation, we find no case where a creditor was allowed to surrender his preference after judgment against him, and thus save his right to have his claim allowed.

This question under the present act has been before the Court in the following cases:

In Re Richard, 94 Fed. Rep., 633.
In Re Owings, 109 Fed. Rep., 624.
In Re Keller, 109 Fed. Rep., 162.
In Re Greth, 112 Fed. Rep., 978.

The last three of these cases follow the decisions under the former law, and in the first the facts were so different that the reasoning of the court is scarcely applicable to the question now before the Court.

In Re Greth, which is the latest case on this subject we have been able to find, Judge McPherson reviews the authorities at some length and comes to the conclusion that the surrender by the claimant must be voluntary; that after contesting the validity of his preference to final judgment he cannot then surrender because he no longer has anything to surrender, having been unwillingly deprived of the same.

It has been said that this is a "harsh rule in case the creditor has acted in good faith, without actual fraud on his

part." But the courts have nothing to do with the harshness of the rule, except as the same may assist us in arriving at the intention of the legislature.

The intention of Congress, however, to establish a "harsh rule," if such it must be called, is conclusively demonstrated, we think, by adopting paragraph g, section 57, having in mind the construction given to the act of 1867 prior to the amendment of 1874. Besides, the reasoning of such eminent Judges as Dillon, Blatchford and Wallace, in the decisions already quoted, not only gives the reason for the rule, but amply justify its wisdom.

> "Second: Upon the issue as to the allowance of the bank's claims was it competent, in explanation of the judgment of the Ohio Circuit Court in favor of the trustee and against the bank in respect of its $2,000.00 mortgage, to show the disclaimer made in open court by the attorney, representing the bank, of any claim of preference, and the grounds upon which the bank declined to consent to a judgment in favor of the trustee?"

In the action of the trustee against the Tiffin Savings Bank to avoid the mortgages there were two causes of action — one to avoid the $4,000.00 mortgage and the other to avoid the $2,000.00 mortgage. In the Court of Common Pleas the Bank was successful on the first cause and the trustee on the second cause. The Bank did not appeal, but the trustee did. Under the statutes of Ohio (section 5225) an appeal takes up the whole case, and it is tried de novo, in form at least, in the appellate court. The trustee had no desire to appeal from the judgment of the Common Pleas Court on the $2,000.00 mortgage, because on that he had

been successful. But under the statutes he could not separate the two causes of action at that stage of the litigation and appeal from only one cause. He could in the first place have brought two action — one on each mortgage. An appeal then in either case would have left the judgment in the other case undisturbed. Can it be claimed then that because the trustee brought one action instead of two, in order to save costs, that that fact gave the Bank one more chance to surrender?

It is true that the appeal vacated the judgment; but if the Bank then surrendered its preference on the $2,000.00 claim, it did so nevertheless because the judgment of the Common Pleas Court was against it and did not do so voluntarily. In the language of Judge Hopkins in the Stephens case, from which we have already quoted: "A party should not be allowed to experiment and speculate upon the ability of the assignee to prove a case against him. * * * * And if on examination, I should conclude I had the power to prevent it, I shall expect a party to elect, and having elected, shall hold him to his election."

There is another and equally important consideration in answering the second question. The record of the case in the Circuit Court shows that there was a trial and that a judgment was rendered against the Bank annulling the $2,000.00 mortgage. This judgment operated on the particular real estate in question, and was therefore a judgment in rem and conclusive whenever and wherever the fact of such judgment was in controversy. The finding and judgment further furnish conclusive evidence that the validity of the $2,000.00 mortgage was tried and decided. Evidence that the Bank abandoned its claim to this mortgage at the trial would contradict the record. There is no uncertainty as to what issue was decided and therefore no occasion for parol evidence to show the facts.

The principles here applied are so well settled that we need not cite authorities.

We claim then that the evidence of what was said by attorneys at the trial was irrevelant because it was then too late for the Bank to surrender its preference; that in any event it did not amount to a surrender; and that it was incompetent because it contradicts the record.

> "Third: If the failure to 'voluntarily' surrender the mortgage given to secure the $2,000.00 note operates to prevent the allowance of that note, does the penalty extend to and require the disallowance of both the other claims?"

This question has been answered in the affirmative by the Circuit Court of Appeals for the Eighth Circuit, in the case of Swartz vs. Fourth Nat. Bank, 117 Fed. Rep., 1.

At page 5 of the report, the Court, after quoting section 57g of the bankrupt law, say:

"The unequivocal language and the unquestionable legal effect of this section are to prohibit the allowance of any claim of a creditor who has received a preference, either upon that or upon any other claim he holds against the estate of the bankrupt, unless he has first surrendered his preference."

It seems to us that virtually the same question was decided in the same way by this Court in the case of

Perie, et al. vs. Chicago T. & T. Co. 21 S. C. Rep., 906.

The second syllibus of that case is as follows:

> "2. A creditor who has received payments of money from an insolvent debtor within four months before petition in bankruptcy was filed for the debtor, but who did not know or have reasonable cause to believe

> that the payments were intended to give him a preference, the debtor not intending to give a preference, cannot be compelled, under the bankruptcy act, 60b, to repay the money to the trustee in bankruptcy, **but under 57g he must surrender the preference that he has received, before any claim by him against the estate can be allowed.**"

The object of the bankrupt law is to secure the equal distribution of the bankrupt's estate among his creditors, so far as it can be done. The Savings Bank had three claims against Goetz all belonging to the same class. It received a voidable preference, by way of mortgage security, on one of them which it refused to surrender, and it thereby forfeited its right to have any of its claims allowed. The case stands just as though the three claims had been united into one and a mortgage given to secure $2,835.00, instead of $2,000.00.

Respectfully submitted,

HENRY WELLER and
BUNN & ROYER,
Attorneys for Plaintiff.

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JAMES H. McKENNEY,
Clerk.

Supreme Court of the United States.

October Term, 1904.

GUILFORD B. KEPPEL, TRUSTEE, ETC.,
vs.
TIFFIN SAVINGS BANK.
No. 116.

Brief for the Tiffin Savings Bank.

GEORGE E. SENEY,
MILTON SAYLER,
JOHN L. LOTT,
for the Savings Bank.

Supreme Court of the United States.

October Term, 1904.

GUILFORD B. KEPPEL, TRUSTEE, ETC.,
vs.
TIFFIN SAVINGS BANK.
No. 116.

Brief for the Tiffin Savings Bank.

Three questions are certified to this court by the Circuit Court of Appeals for decision. They involve the construction to be placed upon the word "preferences" in paragraph "*g*," section 57 of the act of July 1, 1898, (30 Stat. 554, 560,) commonly called the Bankrupt Act. That paragraph reads as follows:

> The claims of creditors who have received *preferences* shall not be allowed unless such creditors shall surrender their preferences.

The pertinent facts are these:

Immediately after Goetz was adjudged a bankrupt, a trustee was appointed, who brought suit in the Court of Common Pleas of Seneca County, Ohio, (the bankrupt being a citizen of that county,) to have declared void the two mortgages given by Goetz to the Savings Bank. Both courts in which the case was tried held in favor of the bank as to the $4,000 mortgage, but against it as the $2,000 mortgage.

When the bank presented its three notes for allowance, the referee refused to permit the bank to make proof as to any of them, for the reason that it had not made a *vol-*

untary surrender of its mortgage given to secure its $2,000 note. The failure to do so, he contended, precluded the allowance of any claim the bank held against the bankrupt. The District Court reversed the action of the trustee and permitted the bank to prove its claims; the trustee took an appeal to the Circuit Court of Appeals, and that court certifies the questions here for decision.

The trustee instituted his suit in accordance with the provisions of sections 6343 and 6344, Revised Statutes of Ohio, as amended April 26, 1898. (93 Ohio Laws, 290.) Section 6343, among other things, provides:

> And every such sale, conveyance, transfer, mortgage or assignment made, * * * by any debtor or debtors, in the event of a deed of assignment being filed within ninety (90) days after the giving or doing of such thing or act, shall be *conclusively* deemed and held to be fraudulent, and shall be held to be void as to the assignee of such debtor or debtors, where upon proof shown, such debtor or debtors were actually insolvent at the time of the giving or doing of such act or thing, whether he or they had knowledge of such insolvency or not. * * *

By section 6344 it is further provided:

> Any creditor or creditors, as to whom any of the acts or things prohibited in the preceding section are void, * * * may commence an action in a court of competent jurisdiction to have such acts or things declared void, and such court shall appoint a trustee according to the provisions of this chapter, who upon being duly qualified shall proceed by due course of law to recover possession of all property so sold, conveyed, transferred, mortgaged or assigned, and to administer the same for the equal benefit of all creditors. * * *

In connection with these Ohio statutes it is proper to call attention to that provision of paragraph "*e*," of section 67 of the Bankrupt Act, which reads as follows:

> And all conveyances, transfers, or incumbrances of his property made by a debtor at any time within

four months prior to the filing of the petition against him, and while insolvent, which are held null and void as against the creditors of such debtor by the laws of the State, Territory, or District in which such property is situate, shall be deemed null and void under this act against the creditors of such debtor if he be adjudged a bankrupt, and such property shall pass to the assignee and be by him reclaimed and recovered for the benefit of the creditors of the bankrupt.

I.

The First Question.

Can a creditor of a bankrupt, who has received a merely voidable preference and who has in good faith retained such preference until deprived thereof by the judgment of a court upon a suit of the trustee, thereafter prove the debt so voidably preferred?

The mortgage having been given by Goetz while insolvent, and within four months of the filing of his petition in bankruptcy, by operation of law alone became absolutely void, and the bank had no preference whatever.

(*a.*) The bank claims that it had no preference whatever within the meaning of the statute. The Ohio law declares that a mortgage to secure a pre-existing debt, given within ninety days of the making of an assignment, "shall be *conclusively* deemed and held to be fraudulent," and shall be held to be void where, upon proof shown, the mortgagor was insolvent at the time of giving the mortgage, whether the mortgagee had knowledge of such insolvency or not. As to such a mortgage, so given, the only question to be determined is whether, at the time of giving, the mortgagor was insolvent. If so, upon a proper determination of that fact, the mortgage at once, *by force of the statute alone*, becomes absolutely void, and no decree of a court can make it more so.

The same thing is true under section 67 of the Bankrupt Act. A mortgage given within four months prior

to going into bankruptcy, if at the time of the giving the mortgagor be insolvent, by force of that section and of the Ohio statute above cited, becomes absolutely void. It becomes void by operation of law, and before any court can act upon it.

Now in the face of these express enactments, what necessity was there for the bringing of a suit to cancel a mortgage which the law already had pronounced dead? The suit was brought to cancel the $4,500 mortgage given some three years before the act of bankruptcy, and which the courts held to be good. This second mortgage was included in the suit, we presume, to have a second pronouncement of the death sentence; or, perhaps, with an idea on the part of the trustee of inflicting punishment after death.

Goetz having been adjudged a bankrupt, and the law having declared the mortgage void if given while Goetz was insolvent, what fact was there about which to contest? Only one; the question of the insolvency of Goetz at the time he gave the mortgage. The burden of showing that fact was upon the trustee. (*In re Chappell*, 113 Fed. Rep. 545.) It is not claimed that the debt is not a *bona fide* one, or that the bank knew at the time that Goetz was insolvent. The bank, therefore, was entitled to a determination of the question whether Goetz was insolvent at the time he gave this mortgage; for if he was not, the mortgage was good, and it could not be said that the giving of the mortgage constituted a preference in any view of the law.

What did the bank really have? Nothing with life or vitality after the act of bankruptcy and after the finding of a state of insolvency at the time of giving the mortgage. The bank had a dead mortgage; to use a common expression, it had "a chicken dead in the shell." It had neither title to, nor possession of, any property of the bankrupt; nor had it any right under the mortgage that

it could enforce, by any sort of proceeding, against either the bankrupt or his creditors.

The mortgage was given three days before the filing of the petition in bankruptcy. The certificate does not disclose when the note, which the mortgage purported to secure, became due. We may fairly presume, therefore, that the note had not become due at the time of the filing of the petition. The note not being due at that time, the bank had neither the title to, nor the possession of, the property described in the mortgage; for under the law of Ohio the title and possession both remain in the mortgagor until the condition in the mortgage is broken. As said in the case of *Lessee of Ely* v. *McGuire*, 2 Ohio, 372:

> The title of mortgaged premises remains in the mortgagor as against all the world, except the mortgagee, and also as against him until it becomes absolute at law, by the non-performance of the condition, and the mortgagee takes legal steps to reduce the premises to possession.

And this rule was again stated in *Bradfield* v. *Hale*, 67 Ohio St. 316, 323.

While in one sense this mortgage may have been a conditional conveyance—a conveyance upon the happening of a certain condition—it never took effect so as to convey, or transfer anything, because the law stepped in and rendered void the instrument before the condition upon which the conveyance was to take place happened. In a general sense, however, in Ohio a mortgage is merely a security for a debt. Thus in *Harkrader* v. *Leiby*, 4 Ohio St. 602, it is said, page 612:

> A mortgage is now treated in both courts (of law and equity) as a mere security for the debt.

Again, in *Sun Fire Office* v. *Clark*, 53 Ohio St. 414, it is said, page 424:

> A mortgage being a mere security for a debt, is extinguished by its payment without any reconvey-

> ance. The mortgage of itself does not make the mortgagee a freeholder, and a judgment recovered against him does not become a lien on the land, nor is it liable to the dower rights of his wife. It has *none of the incidents* of a legal or equitable title.

In *Kernohan* v. *Manss*, 53 Ohio St. 116, speaking of the nature of a mortgage, the court says, page 133:

> Where a promissory note is secured by mortgage, the note, not the mortgage, represents the debt. The mortgage is, therefore, a mere incident of the debt. * * * Being but an incident of the debt, the mortgage remains, until foreclosure or possession taken, in the nature of a *chose in action*. Where given to secure notes it has no determinative value apart from the notes, and, as distinct from them, is not a valid subject of assignment.

Being in the nature of a chose in action, it could not be enforced without action; and it could not be enforced by action, because the statute expressly declared it a nullity.

The trial court having found that at the time of giving the mortgage Goetz was insolvent, (the bank being entitled to have that fact judicially declared before conceding its mortgage to be void,) took no appeal from that finding. Having decided in favor of the bank as to the $4,000 mortgage, the trustee took an appeal to the Circuit Court. That appeal vacated the decree of the Common Pleas Court and took up the whole case for retrial in the Appellate Court. (*Teaff* v. *Hewitt*, 1 Ohio St. 511: *Bassett* v. *Daniels*, 10 Ohio St. 617, 618.) The bank took no appeal and made no claim in behalf of the mortgage in the Circuit Court, its attorneys expressly stating upon the trial that they made no claim of preference under the mortgage. They, therefore, waived any claim to a preference before any final decree was entered against them. The proceeding being equitable in its nature, the case went up on appeal; the whole case was tried anew. There was, therefore, no affirmance of a judgment of the

lower court, but the entering of a decree entirely independent of the decree of the Common Pleas which had been vacated by the appeal.

(*b.*) Having discussed the nature and effect of this mortgage, and of the proceeding to cancel it, we come to the question whether the giving of this mortgage constituted a *transfer* of property within the meaning of section 60, paragraph "*a*," of the Bankrupt Act, as defined in section 1, definition 25, of that act, to wit:

> "Transfer" shall include the sale and every other and different mode of *disposing of or parting with property or the possession of property*, absolutely or conditionally, as a payment, pledge, mortgage, gift, or security.

It must be borne in mind that under this definition it is the disposing of or parting with property, or the possession of property, that constitutes a transfer. Tested in the light of the Ohio decisions, it can hardly be said that this mortgage did any one of the things embraced within the definition. By this mortgage Goetz did not dispose of (that is, alienate) or part with the property, or the possession of the property. The act was not a completed act and would not be until condition broken. The mortgagee acquired nothing under the mortgage until the condition was broken. Before that right attached, the law stepped in and declared the instrument void.

It may be that in some States a mortgage of this character may be regarded as of such a nature as to constitute a preference, but as this case arose in Ohio the question must be determined with reference to its nature there, as declared by the Ohio decisions; and the question of preference decided by considering the effect the Ohio statutes had upon this instrument.

(*c.*) Coming to the Federal decisions, we find a contrariety of opinion as to what constitutes a preference and as to when it shall be surrendered in order to entitle the person holding it to prove his claims. As to the cases cited

in the brief of opposing counsel, it is sufficient to say that most of them arose under the act of 1867, and were cases in which there had been an actual payment of money, or the actual receipt or possession of property, or where the person had been a party to an actual fraud, and cannot be held controlling here. Most of the cases bearing upon the preference clause under the present law may be found in the notes in 1 Fed. Stat. Annotated, pp. 664, 665, to which the court is referred.

In the case at bar, in reversing the action of the trustee in refusing to permit the bank to prove its claims, Judge Wing, speaking with respect to the rights the bank acquired under the mortgage, says:

> It (the bank) had a fancied right which it sought to enforce, but in fact had no rights in the mortgage whatever. The mortgage was absolutely void, both under the Bankrupt Act and the State law, and was so decreed by the State courts.

In the case of *Pirie* v. *Trust Co.*, 182 U. S. 438, the question was whether a payment of money was a transfer of property within the meaning of the law. The court held it to be a transfer because it was the giving or conveying of something of value. There, however, there was an actual payment and delivery of property— a completed transaction—a passing of property.

In *Bank* v. *Massey*, 192 U. S. 138, this court, in defining what acts constitute a transfer, says, page 147:

> These transfers of property, amounting to preferences, *contemplate the parting with the bankrupt's property* for the benefit of the creditor and the consequent diminution of the bankrupt's estate. It is such transactions, operating to defeat the purposes of the act, which under its terms are preferences.

In this case there was no parting with property and no contemplation of parting with it. The fact that Goetz gave a mortgage which did not pass title or possession, rebuts the idea that he contemplated parting with his

property. Had a parting with the property been contemplated, it is fair to presume that a deed of some sort would have been given the bank by Goetz,

A brief reference to the cases cited by opposing counsel under the present law is appropriate.

In re Richard, 94 Fed. Rep. 633, was a case where certain judgments were obtained within four months of the filing of the petition in bankruptcy, upon which executions were sued out and levies made. It also appears some payments had been made thereon. In answer to the question whether the judgment creditors should be permitted to prove their claims after contest, the court says, page 637:

> There is no denial of respondents' "debt," as defined in section 1, nor allegations that there was any actual fraud in obtaining the judgments—only such fraud of the bankrupt law as vitiates any lien acquired. The debts are due. Respondents have received and can receive no preference, lien, or advantage by reason of or under the judgments of the magistrate's court. *They are nullities* in this court to this extent. * * * Respondents have attempted to gain an advantage and failed. These proceedings as far as gaining a lien, are void. The respondents must * * * refund what has been collected under these proceedings. They are still creditors of the bankrupt, after a fruitless fight. They have gained no advantage and acquired no lien, but are still creditors unsecured. Should they be punished by a loss of their debts because they were vigilant? The law does not so provide. It favors vigilance, especially when untainted with fraud. * * * Respondents have received no preference and been parties to no actual fraud, but only to such fraud of the operation of the Bankrupt Act as vitiates their proceedings. They are creditors, and on a surrender of the amount collected of the bankrupt estate, are entitled to prove their claims as other unsecured creditors.

In re Owings, 109 Fed. Rep. 623, was a case where the creditor had accepted a stock of goods of the debtor in

satisfaction of a debt, within four months of the filing of a petition in bankruptcy, well knowing at the time the goods were taken that the debtor was insolvent. Upon suit brought to recover the value of the goods received, the creditor offered to return $900, claiming that to be their value. The trustee recovered a judgment for $1,400. The creditor was not allowed to prove his claim. But this was on the theory that from the beginning the creditor was a wrongdoer, and did not come into court with clean hands.

But that is not this case. It is not claimed, and the record does not show, that at the time of taking this mortgage the Savings Bank had any knowledge that Goetz was insolvent. In the absence of such a showing, the presumption is the bank had no such knowledge. *Bank* v. *Massey*, 192 U. S. bottom page 148.

All that was held in *In re Keller*, 109 Fed. Rep. 118, was, that a creditor who had received a payment on his claim within four months, the debtor at the time being insolvent, must return the payment before he could share in the distribution of the estate. The court points out (pp. 124, 125) that such a creditor has a choice of two things: either to return the payment and share in the distribution, or retain the payment and be denied the right to share in the proceeds.

In re Greth, 112 Fed. Rep. 978, holds, however, that where a judgment has been obtained within four months of the filing of a petition in bankruptcy, and the judgment creditor defends his judgment, he is not permitted to share in the proceeds, although he has never received anything upon the judgments. We fail to see the force of the reasoning in this case. What was there to contest? The judgments were rendered within four months of the beginning of proceedings in bankruptcy; the debtor had been adjudged a bankrupt; insolvent at the time of the taking of the judgments. The statute nullified the

judgments; there was nothing for the decree of a court to act upon, and a suit to declare void a judgment already by statute made void is a useless proceeding. It could not even be claimed that such a judgment would be a cloud upon the title of the property of the bankrupt, for it would be cancelled by operation of law.

Swarts v. *Bank*, 117 Fed. Rep. 1, was a case where a creditor had received a payment upon its claim within the prohibited time. The court held that the payment must be surrendered before the creditor could share in the distribution. Speaking of the rule for determining a preference, the court says, page 4:

> The test of a preference under the act is the *payment*, out of the bankrupt's property, of a larger percentage of the creditor's claim than other creditors of the same class receive.

Payment is made the test of a preference; and in the case at bar there was no payment. (As to payment see *Bank* v. *Gettinger*, 68 Ohio St. 400.)

In *In re Steam Vehicle Co.*, 121 Fed. Rep. 939, Judge McPherson (who delivered the opinion in *In re Greth*, *supra*) held that "*payment* means at least that value has passed in some form or other" from the bankrupt to the creditor.

Western Tie & Lumber Co. v. *Brown*, 129 Fed. Rep. 728, was a case where the bankrupt owed the company a large amount of money. In the course of their dealings and within four months of the time of going into bankruptcy it retained and credited upon its claims certain moneys due the bankrupt, which it had retained from amounts paid his workmen. The question whether the retention of this money and the applying it upon the claim created a preference was contested, not only before the referee and the District Court, but also in the Circuit Court of Appeals—all holding that it constituted a preference. The Court of Appeals points out that the test of a prefer-

ence is the transfer—the passage of the property of the debtor to the creditor. Notwithstanding the contest made by the company the latter court permitted it to prove its claim upon repayment to the trustee of the moneys retained by it.

We respectfully submit that, even if the bank had assigned this mortgage to the trustee, nothing would have been added to the estate, for it was not property, and would not have been a transfer of property. It was a thing which had neither life nor force, since the statute declared it to be *conclusively* void. The bank had received nothing of value from its debtor and had nothing to return. It should, therefore, be permitted to prove its claims before the trustee.

Again: The referee held that the bank had not made a *voluntary* surrender of its so-called preference, and therefore was not entitled to prove its claim. By so holding the referee read into the act something that is not there. The language of the act is *surrender*, not *voluntary surrender*. If a referee may inject into the act the word *voluntary*, it would be but a step further to require that a *willing*, a *cheerful* or even a *joyful* surrender be made. Webster defines *surrender* as the giving or delivering possession of anything upon *compulsion* or demand, and the same definition is to be found in the Standard and Century dictionaries. If the ruling of the referee be correct, then a creditor who, in good faith, has accepted a payment or security, without knowledge of the insolvency of his debtor, must blindly surrender that which he has received, without an opportunity for a determination of the question of insolvency at the time of the receiving of the payment or security, or of the question whether that which he has received constitutes a preference. The creditor is not required to submit to the ruling of the referee, but is entitled to the decision of the court upon the point. (Sec. 57, par. *f*.) If the contention of the referee be correct, then the mere submission of a question

to a court for decision deprives the creditor of a right to prove his claims. We submit the law does not so provide.

That the construction here contended for is the correct one is apparent from the fact that a *bona fide* creditor who, without knowledge of the insolvency, has received a preference, has the option of retaining his preference and not participating in the distribution of the fund, or surrendering his preference and participating. *In re Keller*, 109 Fed. Rep. 124, 125. This rule applies where the creditor has acted in good faith. And, as pointed out in the recent case of *Kaufman* v. *Treadway, Trustee*, (decided November 28, 1904,) Mr. Justice Brewer delivering the opinion, Congress did not extend the rule to creditors who knowingly participate in any fraud.

We submit that the bankrupt act aims to protect the equities of all creditors, and we do not believe such a construction should be placed upon it as will deprive the bank of its right to prove its just claims, in order to increase the dividends of other creditors of the same class, merely because the bank, in the suit to set aside its mortgage given three years before the act of bankruptcy (and in which the second mortgage was also included), which was held to be valid, insisted that it was entitled to a judicial determination of the question whether, upon the facts and the law, it being a *bona fide* creditor, and not a party to any fraud, its later mortgage did or did not amount to a preference.

II.

The Second Question.

Upon the issue as to the allowance of the bank's claims, was it competent, in explanation of the judgment of the Ohio Circuit Court in favor of the trustee and against the bank in respect of the $2,000.00 mortgage, to show the disclaimer made in open court by the attorney representing the bank of any claim

of preference, and the grounds upon which the bank declined to consent to a judgment in favor of the trustee?

Upon this point the certificate is silent as to the character of testimony offered to show the disclaimer made by the attorneys for the bank upon the trial of the case in the Circuit Court. In the absence of a showing of its nature, the presumption is that the proof offered (if proper proof could be offered for that purpose) was proper. We submit that (for the purpose of showing the waiver) it was competent to introduce the record of the case made in that court for the purpose of showing just what occurred upon the trial, and upon what the decree was based.

The laws of Ohio provide for the appointment of official stenographers. (Rev. Stat. 475 *et seq.*; 91 Ohio Laws, 688.) They are required to take an oath of office. When called upon to do so in any case, it is the duty of the official stenographer to take accurate shorthand notes of all the proceedings, "which notes shall be filed in the office of the official stenographer, and preserved." These notes, therefore, become a part of the official record in the case. If requested, it is the duty of the stenographer to extend his notes into longhand; otherwise he does not. Where such notes have not been extended, it would be entirely competent to call the stenographer, with his notes, to the witness stand, and have him read his notes upon such points as may be desired. It would have been perfectly competent, then, (there being an official stenographer of the Circuit Court of Seneca County,) to have called him to the witness stand, with his official notes, and have him read just what his notes showed with respect to the disclaimer made by the attorney for the bank in the Circuit Court. And as a matter of fact, this was what was done. Being part of the official record of the case, we submit such proof was competent, and should be so held.

III.

The Third Question.

> If the failure to "voluntarily" surrender the mortgage given to secure the $2,000.00 note operates to prevent the allowance of that note, does the penalty extend to and require the disallowance of both the other claims?

Upon this point the decisions are so conflicting that we cannot do better than to refer the court to the learned opinion of Judge Hammond in the case of *In re Wolf & Levy*, 122 Fed. Rep. 127, in which reference is made to the various decisions upon the point. (pp. 132–140.)

We respectfully submit that the first and second questions should be answered in the affirmative and the third in the negative.

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DECEMBER 12, 1904.